"there will be situations where a Federal income tax deficiency will not be as narrowly focused" and that interest paid on a tax deficiency may not be an ordinary and necessary business expense.[27] The court specifically noted that Miller I and Miller II involved just such a situation.[28]

The Tax Court was badly divided in *Redlark*.[29] Eight judges agreed with the majority opinion, six dissented and several wrote concurring opinions.

In conclusion

At the moment, for taxpayers in the Eighth Circuit Court of Appeals area, the regulation has been declared valid.[30] Outside the Eighth Circuit, the Tax Court view prevails that the temporary regulation is invalid but that the interest must be an ordinary and necessary business expense to be deductible.[31]

But *Redlark* [32] may be appealed. In any event, the last word has probably not been written on this issue.

FOOTNOTES

1 I.R.C. § 163(h)(2)(A). See Temp. Treas. Reg. § 1.163-9T(b)(2)(i)(A). See generally 4 Harl, *Agricultural Law* § 28.05[3] (1995); Harl, *Agricultural Law Manual* § 4.03[12] (1995).

2 Miller v. United States, 65 F.3d 687 (8th Cir. 1995), *aff'g*, 95-1 U.S.Tax Cas. (CCH) ¶ 50,068 (D. N.D. 1994) (Miller II). An earlier decision involving the same controversy (Miller I) was decided in 1993. Miller v. United States, 841 F. Supp. 305 (D. N.D. 1993).

3 Redlark v. Comm'r, 106 T.C. No. 2 (1996).

4 I.R.C. § 62(a)(1).

5 Pub. L. 99-514, Sec. 511(b), 100 Stat. 2085, 2246, adding I.R.C. § 163(h).

6 I.R.C. § 163(h)(1).

7 I.R.C. § 163(h)(2)(A).

8 H. Conf. Rep. 99-841 at II-154 (1986).

9 Staff of Joint Comm. on Tax'n, General Explanation of the Tax Reform Act of 1986 at 266 (1987).

10 *Id.*

11 52 Fed. Reg. 48409 (Dec. 22, 1987), adding Temp. Treas. Reg. § 1.163-9T.

12 Temp. Treas. Reg. § 1.163-9T(b)(2)(i)(A).

13 841 F. Supp. 305 (D. N.D. 1993).

14 *Id.*

15 I.R.C. §§ 62(a), 162.

16 Miller v. United States, 95-1 U.S. Tax Cas. (CCH) ¶ 50,068 (D. N.D. 1994).

17 *Id.*

18 *Id.*

19 Miller v. United States, 65 F.3d 687 (8th Cir. 1995).

20 Tippin v. Comm'r, 104 T.C. 518, 529 (1995) (taxpayer did not show relationship between interest expense and any business); Rose v. Comm'r, T.C. Memo. 1995-75 (taxpayer failed to show tax attributable to trade or business or investment activity); Crouch v. Comm'r, T.C. Memo. 1995-289 (deduction disallowed for portion of tax attributable to business because of failure of proof and interest was for previous year). See Sheerazi v. Comm'r, T.C. Memo. 1994-245 (personal interest).

21 106 T.C. No. 2 (1996).

22 *Id.*

23 *Id.*

24 Temp. Treas. Reg. § 1.163-9T(b)(2)(i).

25 106 T.C. No. 2 (1996).

26 *Id.*

27 *Id.*

28 *Id.*

29 *Id.*

30 Miller v. United States, 65 F.3d 687 (8th Cir. 1995).

31 Redlark v. Comm'r, 106 T.C. No. 2 (1996).

32 *Id.*

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

ANIMALS

HORSES. The plaintiff was injured when the plaintiff's car struck a horse on a highway. The horse belonged to the defendant and had escaped after a parked truck rolled down a slope and crashed through the fence holding the horse. The evidence demonstrated that, except for the breach in the fence caused by the truck, the fence was in good repair and sufficient to prevent the horse from escaping. Although the jury found for the plaintiff, the trial court entered judgment for the defendant notwithstanding the verdict because the evidence showed that the fence was in good repair. The appellate court affirmed, agreeing that no evidence was presented that the defendant or any agent, employee or resident of the defendant was responsible for the breach in the fence. The evidence showed that the truck was parked on a slope in gear and with its parking brake engaged. After the accident, the truck was out of gear and the parking brake was off. **Butcher v. White's Iowa Institute, 541 N.W.2d 262 (Iowa Ct. App. 1995)**.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

AVOIDABLE TRANSFERS. The debtor was a corporation which operated a feedlot. The corporation was wholly-owned by the defendant who was also the president and principal employee of the debtor. The defendant was convicted of a check kiting scheme using the debtor's funds. The trustee sought to recover prepetition payments made to creditors during the check kiting as fraudulent transfers. The trustee argued that the defendant's guilty plea in the check kiting case was prima facie evidence that the payments to creditors were made with intent to defraud creditors. The court held that the guilty plea was prima facie evidence of intent to defraud only as to the two banks used in the check

kiting scheme and that the defendant's intent as to the other creditors' payments was an issue of fact which precluded summary judgment on the issue of recovery of the payments as fraudulent transfers. ***In re*** **KZK Livestock, Inc., 190 B.R. 626 (Bankr. C.D. Ill. 1996)**.

EXEMPTIONS

HOMESTEAD. The debtors owned 80 acres of rural land which included 78 acres used for the residence and cultivation and two acres used for an auto repair business. The debtors claimed the entire 80 acres as an exempt rural homestead. The trustee objected, arguing that the homestead exemption, Okla. Stat. tit. 31, § 2, limits the exemption to $5,000 where the homestead is also used for a business. The court noted that the cases which agreed with the trustee's argument involved only homesteads within city limits. The court held that the business use limitation did not apply to rural homesteads, based on statutory construction of the homestead exemption statute which appeared to distinguish between rural and city homesteads for purposes of the business limitation. As the debtor noted, the trustee's argument would deny a rural homestead exemption to all farms and ranches. ***In re*** **Ward, 190 B.R. 427 (Bankr. W.D. Okla. 1995)**.

CHAPTER 12-*ALM* § 13.03[8].*

DISMISSAL. A creditor had obtained a pre-petition judgment against the debtors and had docketed the judgment, creating a judgment lien against the debtors' property. The debtors subsequently filed for Chapter 12 and obtained a ruling voiding the judgment lien under Section 547. The Chapter 12 case was dismissed by the debtors and the debtors filed for Chapter 11 with the case eventually converted to Chapter 7. After the debtors received a discharge in the Chapter 7 case, the judgment creditor sought to vacate the Chapter 12 order voiding the judgment lien. The court held that, upon dismissal, a voided lien is automatically reinstated unless the debtors seek an order not to reinstate the lien; therefore, the burden is on the debtors to demonstrate a reason for not reinstating of the lien. In addition, the court held that the discharge in Chapter 7 had no effect on the reinstatement of the lien because the debtors did not seek an order not to reinstate the lien and because a discharge only affects the debtors' personal liability as to a lien and not the enforcement of the lien against property. The debtors also argued that the creditor had entered into a stipulation which was the basis of the original lien avoidance and which estopped the creditor from reinstating the lien. The court held that this issue could best be resolved in a state court when the creditor sought to enforce the lien. Finally, the court held that the debtors failed to demonstrate any unfairness to other creditors from allowing the reinstatement of the lien; therefore, the lien was reinstated by the Chapter 12 dismissal. ***In re*** **Derrick, 190 B.R. 346 (Bankr. W.D. Wis. 1995)**.

PLAN. The debtors operated a citrus farm which had produced 3,800 boxes of fruit. The debtors had planted an additional 20 acres of new trees and projected steady increases in the number of boxes of fruit to be harvested during the Chapter 12 plan years with the third year producing almost three times as many boxes of fruit than the farm produced historically. The debtors did not plan any additional labor or equipment costs to cover the increased maintenance and harvesting costs of the additional fruit.The plan also provided only $480 per month for living expenses for three people, two residences and two automobiles. The court held that the plan was not confirmable because it was not feasible since the plan was overly optimistic about increased harvests from new trees without additional labor or equipment. The court also held that the plan failed to provide sufficient living expenses or provide any buffer against unexpected difficulties. ***In re*** **Gough, 190 B.R. 455 (Bankr. M.D. Fla. 1995)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

AUTOMATIC STAY. After the taxpayer filed for Chapter 7, the IRS sent the taxpayer a Notice of Proposed Assessment of the 100 percent penalty under I.R.C. § 6672 as a responsible person of a corporation which failed to pay employment taxes. The notice provided that if the debtor failed to protest the notice, the IRS would proceed with the assessment of the penalty. The court held that the notice was an attempt to initiate an assessment of a penalty and was void as a violation of the automatic stay. **Riley v. Comm'r, 96-1 U.S. Tax Cas. (CCH) ¶ 50,090 (E.D. Mo. 1995)**.

DISCHARGE. The debtors owed taxes for 1989. In December 1990, the debtors filed for Chapter 13 and the case continued until it was dismissed in June 1992. The IRS assessed the debtors for the unpaid 1989 taxes more than 240 days before the instant bankruptcy case was filed. The IRS argued that, under Section 108(c) and I.R.C. § 6503(h), the intervening Chapter 13 case tolled the provisions in Sections 507(a)(8) and 523(a)(8)(B) which provide that taxes due more than three years prior to the bankruptcy filing were dischargeable. The court held that I.R.C. § 108(c) and I.R.C. § 6503(h) apply to toll the three year period of Section 507(a)(8) during the intervening Chapter 13 case; therefore, the 1989 taxes were nondischargeable because the tax return was due within three non-tolled years before the petition for the current case. ***In re*** **Shedd, 190 B.R. 692 (Bankr. M.D. Fla. 1996)**.

PREFERENTIAL TRANSFERS. The debtor had made several payments of employment taxes to the IRS within 90 days before filing the Chapter 11 petition. The payments were not designated by the debtor and the IRS applied the payments to non-trust fund taxes owed by the debtor. The debtor sought to avoid and recover the payments as preferential under Section 547(b). The court found that the debtor was insolvent during the 90 day pre-petition period, the payments were made for the benefit of the IRS, and the IRS received more than it would have if the debtor filed for Chapter 7 before the payments were made. The court held, however, that the debtor had a beneficial interest in the payments only to the extent the payment represented the debtor's share of the social security tax on the wages paid. In addition, the court held that the payments were not made for an antecedent debt but were made for taxes due after the payments were made (an employer's social security taxes are due at the end of the employment quarter); therefore, the payments were not preferential under Section 547(b). After reconsideration, the court held that the

payments made after the date for which penalties would be assessed were payments made for an antecedent debt and were recoverable as preferential transfers. The IRS also argued that the late payments were excepted from the preferential transfer rules in that the payments were made in the ordinary course of business. The court held that the debtor had a history of making timely payments; therefore, the late payments were not made in the ordinary course of business. ***In re* Pullman Const. Industries, Inc., 190 B.R. 618 (Bankr. N.D. Ill. 1996), *aff'g in part and rev'g in part on reconsideration*, 186 B.R. 88 (Bankr. N.D. Ill. 1995)**.

CONTRACTS

MERCHANT. The plaintiff was a university which purchased a grain dryer for use on its research farms. The defendant had manufactured a part in the dryer which failed, causing a fire which damaged the plaintiff's property. The plaintiff sued in tort for damages to the other property and the defendant argued that the action was barred by Minn. Stat. § 604.10(a) because the purchase was made between merchants in the goods involved. The court held that the university was a merchant with respect to the dryer because (1) the university had purchased six units prior to the dryer involved, (2) the university was a sophisticated buyer and used a bid process, and (3) the university used an expert on grain dryers to make the purchase. **Board of Regents of Univ. of Minn. v. Chief Industries, 907 F. Supp. 1298 (D. Minn. 1995)**.

RELEASE. The plaintiff had contracted with the defendant for the defendant to provide and apply fertilizer and the herbicide Treflan to 19 acres of safflower. The applicator hired by the defendant failed to properly clean the herbicide applicator equipment and the herbicide Velpar contaminated the fields, causing immediate damage to the safflower fields. The parties negotiated payment for the damage and the plaintiff signed a release which held the defendant harmless for "any and all damages caused by the spraying of my approximate nineteen acres of safflower." The plaintiff sued for breach of contract when it became clear that the contamination continued in subsequent crop years. The defendant first argued that the action was barred by the statute of limitations on tort actions. The court held that the action was not barred by the statute of limitation for tort actions because the plaintiff's petition raised no tort issues and the facts and claims alleged by the plaintiff were consistent with a breach of contract action. The plaintiff sought to overcome the release by oral extrinsic evidence that the parties intended the release to apply only to the safflower crop and not to subsequent crops. The defendant argued that the statute of frauds prevented any extrinsic evidence. The court held that the language quoted above was sufficiently ambiguous to allow extrinsic evidence on the issue of the crop years covered by the release. **Ward v. Intermountain Farmers Ass'n, 907 P.2d 264 (Utah 1995)**.

FEDERAL AGRICULTURAL PROGRAMS

PESTICIDES. See *Hochberg v. Zoecon Corp. infra* under **Products Liability**.

FEDERAL ESTATE AND GIFT TAX

APPORTIONMENT OF TAXES. The decedent's estate included a QTIP trust received from the decedent's predeceased spouse. The decedent's will provided that "all transfer, estate or inheritance taxes…imposed by any taxing authority upon or in relation to…any trust…included as part of my taxable estate, shall be paid as an expense out of my residuary estate." The estate had claimed the taxes attributable to the QTIP trust against the trust but the IRS argued that the will provision controlled and the taxes had to be paid out of the residuary estate, lessening charitable distributions from the residuary estate. Under Ohio Rev. Code § 2113.86(l), "the estate is entitled to recover from the persons holding or receiving the property any amount by which the estate tax payable exceeds the estate tax that would have been payable if the value of the property had not been included in the gross estate of the decedent. This division does not apply if a decedent provides otherwise in his will or another governing instrument and the will or instrument refers to either section mentioned in this division or to qualified terminable interest marital deduction property." The court held that Ohio Rev. Code § 2113.86(l) required the decedent's will to specifically mention the QTIP trust as relieved from its share of estate tax and that the will's use of the term "any trust" was not specific enough to change the presumption that estate tax attributable to the QTIP trust was to be charged to the trust. **Estate of Vahlteich v. Comm'r, 95-2 U.S. Tax Cas. ¶ 60,218 (6th Cir. 1995)**.

The decedent was the beneficiary of a QTIP trust established by the will of the predeceased spouse. Under the trust, at the decedent's death accumulated income passed to the decedent's estate and principal passed as directed by the predeceased spouse's will. The decedent's will contained a general "pay-all-taxes" clause which provided that the estate was to pay all estate and inheritance taxes "without seeking reimbursement from or charging any person therefor." The estate reduced the amounts paid to the trust remainder beneficiaries by the amount of estate and inheritance taxes attributed to the inclusion of the QTIP trust in the decedent's estate. The beneficiaries objected, arguing that the "pay-all-taxes" clause relieved the trust from charges for the taxes relating to the trust. The court held that because the "pay-all-taxes" clause did not specifically mention nonprobate property or the QTIP trust, the QTIP trust was responsible for the estate and inheritance taxes attributable to the trust. The court noted that there was no evidence that the decedent intended to benefit the remainder beneficiaries of the predeceased spouse's bequest at the expense of the decedent's specific bequests. **Matter of Will of Cooney, 541 N.W.2d 467 (Wis. 1995)**.

GENERATION SKIPPING TRANSFERS-*ALM* § 5.04[6].* In December 1983, the grantors created an irrevocable trust for their child. The trust provided for the child to have a special power of appointment to appoint by will the trust corpus to the child's heirs or to the grantors' heirs. If the power of appointment was not exercised the trust passed to the child's heirs, or if no heirs survived, to the

grantors' heirs. The trust could not be extended more than 21 years past the death of the last survivor of the heirs living in December 1983. The child had executed a will which appointed the trust to separate trusts for the child's heirs. The IRS ruled that the trust was not subject to GSTT because (1) it was irrevocable prior to September 25, 1985, (2) the power of appointment was not exercised in a manner which extended the life of the trust more than 21 years after the death of a person living in December 1983, and (3) the exercise of the power of appointment did not constitute a constructive addition to the trust. **Ltr. Rul. 9607011, Nov. 9, 1995**.

IRA. The decedent's estate included an IRA which had a trust as the remainder beneficiary. The trust provided that it was to be split into a marital trust and a residuary trust with the surviving spouse as the beneficiary and one of two cotrustees of both trusts. The marital trust was to be funded with the lesser of the maximum estate tax marital deduction or the amount necessary to reduce the estate tax to zero. The surviving spouse had the power to withdraw any marital trust property. The surviving spouse and the other cotrustee allocated the maximum amount of the IRA to the marital trust and then the surviving spouse withdrew the IRA funds and placed them in the surviving spouse's own IRA within 60 days. The IRS noted that the general rule is that the transfer of IRA funds to a third party would prevent the surviving spouse from rolling the funds over to another IRA without penalty. However, because the original trust was a beneficiary of the decedent's IRA, the surviving spouse would be treated as having received the IRA funds from the decedent and the rollover of the funds to the surviving spouse's IRA would not cause the IRA funds to be included in the surviving spouse's gross income. **Ltr. Rul. 9608036, Nov. 29, 1995**.

POWER OF APPOINTMENT. An irrevocable trust was created in 1974 by a now-deceased grantor. The trust provided for two individuals and one corporation as trustees. One of the trustees died and the remaining individual trustee appointed the grandchildren of the original grantor as co-trustees and amended the trust to provide that if an individual trustee removes the corporate trustee, the successor corporate trustee cannot be related or subordinate to the individual trustee. The IRS ruled that the new trustees did not have a power of appointment over trust principal. The IRS noted that its original position, as stated in *Rev. Rul. 79-353, 1972-2 C.B. 325*, has been changed by *Rev. Rul. 95-58, I.R.B. 1995-36, 16*, to provide that individual trustees do not have a power of appointment over trust principal where the trustee has the power to remove and replace another trustee so long as the successor trustee is not related or subordinate to the trustee. **Ltr. Rul. 9607008, Nov. 9, 1995**.

TRUSTS. The plaintiffs transferred their residence to a ten-year qualified personal residence trust as part of their estate planning. The trust provided that the plaintiffs retained a right to live on the property during the term of the trust. The plaintiffs were the cotrustees of the trust and as cotrustees applied for a homestead exemption from ad valorem state taxes in Florida. The county appraiser rejected the homestead exemption, arguing that the residence was not permanent because the plaintiffs only had the right to live on the property for a maximum of ten years. The court held that the exemption statute had no time limit for residency of the permanent resident and only required a beneficial interest in the property by the person claiming the exemption. The court held that a residence in a QPRT was eligible for the exemption. **Robbins v. Welbaum, 664 So.2d 1 (Fla. Ct. App. 1995)**.

VALUATION. The decedent had received a portion of the predeceased spouse's estate in a QTIP trust. After the death of the predeceased spouse, the estate and the decedent formed two partnerships funded with the estate property and the decedent's own property. The estate then funded the QTIP trust with its shares of the partnerships; thus, the decedent owned a portion of the partnerships in fee and a portion through the QTIP trust. The IRS ruled that the partnership interests were to be aggregated for purposes of valuation for estate tax purposes in the decedent's estate. **Ltr. Rul. 9608001, Aug. 18, 1995**.

FEDERAL INCOME TAXATION

BUSINESS DEDUCTIONS. A corporation was not allowed deductions for repairs made to a house owned by the corporation but used by the corporation's sole shareholder as a residence. The court held that the deductions were disallowed because the repairs benefitted only the shareholder. In addition, the court held that the repairs constituted constructive dividends to the shareholder. **Gill v. Comm'r, T.C. Memo. 1994-92, *aff'd*, __ F.3d __ (6th Cir. 1996)**.

C CORPORATIONS-*ALM* § 7.02.*

CONVERSION. The Treasury Department has announced that it will propose legislation which would amend I.R.C. § 1374 to treat a conversion of a C corporation to an S corporation aa a liquidation taxable at the corporate level followed by contribution of the assets to the S corporation. The new law would be effective only for tax years after Janury 1, 1997. **TDNR RR-885**.

LIQUIDATION. The taxpayer was the sole shareholder of a corporation which operated a campground and concert park. Because of litigation problems with the local government, the taxpayer decided to sell the property and purchase an amusement park elsewhere. A second corporation was formed for the purpose of acquiring the new property. The corporation's property was sold and on the advice of the corporation's accountant, the corporation was dissolved under state law, final income tax returns were filed and distributions were made to the taxpayer. The taxpayer originally listed these distributions as liquidating distributions from the corporation but later filed an amended return which did not include the distributions in income. The taxpayer argued that the distributions were part of a reorganization of the original corporation. The court held that the distributions were taxable as liquidating distributions because a clear intent to liquidate the first corporation was demonstrated by the (1) recitations in the board meeting minutes that the corporation was to liquidate

in accordance with the accountant's advice, (2) the corporation filed final income tax returns, (3) the corporation dissolved under state law, and (4) the corporation sold all of its assets. **Murphy v. Comm'r, T.C. Memo. 1996-59**.

DISCHARGE OF INDEBTEDNESS-*ALM* § 4.02[15].* The taxpayers, husband and wife, were the sole shareholders of a C corporation which operated a national delivery service. The corporation made several distributions to the taxpayers which were characterized on the corporation's books as loans. The corporation had also prepared interest-bearing notes to bolster the evidence that the distributions were loans. During an IRS audit of the corporation's returns, the corporation and taxpayers took the position that the distributions were loans to the taxpayers. Some of the funds were repaid by the taxpayers but most of the distributions were eventually written off by the corporation. The corporation, however, characterized the written off amounts as dividends and not as loans. The court held that the write off of the distributions resulted in discharge of indebtedness income to the taxpayers because the taxpayers had claimed the distributions as loans in the audits. The court noted that the taxpayers had consistently claimed the distributions as loans until the statute of limitations had closed on the tax years involved. **Schneller v. Comm'r, T.C. Memo. 1996-62**.

HOBBY LOSSES-*ALM* § 4.05[1].* The taxpayer owned a small pet shop business which had experienced at least seven straight years of losses. The taxpayer also had full time employment elsewhere but did not receive a high income from that job. The Tax Court held that the taxpayer did not have a profit motive in operating the store because the taxpayer did not maintain an accurate recordkeeping system and did little to increase the store's profitability. The appellate court reversed, holding that the Tax Court did not give sufficient weight to other factors involved in the case, such as the taxpayer's modest income from other sources and the taxpayer's moving of the store to a more favorable location. On remand, the Tax Court affirmed its holding after reviewing all nine factors of Treas. Reg. § 1.183-2(b). The court acknowledged that the employment of the taxpayer's parent in the store could be considered involvement by the taxpayer but the court held that the parent's employment was primarily for the personal pleasure of the parent and for the taxpayer's satisfaction of finding employment for the parent. The Tax Court also held that the taxpayer's relocation of the store did not indicate a profit motive because the taxpayer did not attempt to move the store earlier when several years of losses had already occurred. The Tax Court did acknowledge that the taxpayer's modest income from other sources demonstrated that the store was not operated primarily as a tax shelter of the other income but held that this factor did not outweigh the other indicators that strongly showed no profit motive in operating the store. **Ranciato v. Comm'r, T.C. Memo. 1996-67, *on rem. from*, 52 F.3d 23 (2d Cir. 1995), *rev'g and rem'g*, T.C. Memo. 1993-536**.

The taxpayer had owned and operated a 150 acre farm for 37 years, with 36 of those years producing losses. The case involved only three of those years. In the first year, the taxpayer accepted a teaching job in another state which required the employment of caretakers and neighbors to attend the farm because the taxpayer was required to live in the other state. In holding that the farm was not operated with the intent to make a profit, the court examined the nine factors of Treas. Reg. § 1.183-2(b): (1) the taxpayer failed to keep records sufficient to evaluate the future success or failure of the operation and failed to make changes that would make the operation profitable; (2) the taxpayer had sufficient expertise to run the farm profitably; (3) the taxpayer spent little time on the farm during the tax years involved and the caretakers also spent little time in watching the farm; (4) the taxpayer had not made any other businesses profitable; (5) the farm had a long history of losses; (6) even though some expenses were unexpected, the absence of those losses would not have made the farm profitable; (7) although the land appeared to have appreciated during the taxpayer's ownership, the taxpayer failed to show that the appreciation exceeded the losses; (8) the farm losses generated substantial tax benefits from offsetting the taxpayer's nonfarm income; and (9) the taxpayer's operation of a nonprofitable farm for 37 years indicated that the taxpayer operated the farm primarily for pleasure. **Pearson v. Comm'r, T.C. Memo. 1996-66**.

PARTNERSHIPS-*ALM* § 7.03.*

ADMINISTRATIVE ADJUSTMENTS. The taxpayers were limited partners who held 0.45 percent interests in a limited partnership with more than 100 partners; therefore, the taxpayers were non-notice partners who did not receive notice of an administrative adjustment filed with the tax matters partner (TMP). The TMP signed a settlement agreement which adjusted several items of partnership deductions which passed through to the taxpayers and resulted in deficiencies owed by the taxpayers. The taxpayers challenged the administrative adjustment of partnership items and the IRS moved for summary judgment, arguing that the Tax Court did not have jurisdiction over any challenge of the adjustments, except for mathematical errors. The Tax Court agreed with the IRS, holding that, because the taxpayers held less than a 1 percent interest in a partnership with more than 100 partners, the taxpayers were not required to receive notice of the administrative adjustment and were bound by the settlement agreed to by the TMP. **Vander Heide v. Comm'r, T.C. Memo. 1996-74**.

PASSIVE INVESTMENT LOSSES. The taxpayers owned several condominiums which were rented to third parties during the summer. The properties were managed by a management company which obtained the renters, cleaned the condominiums after each use and maintained the properties. The taxpayers claimed to have spent over 100 hours per year in maintenance of the condominiums, including repainting and cleaning. The court held that the losses from the rental activity of the condominiums were subject to the passive loss rules because (1) the taxpayers did not perform substantially all the participation in the operation of the rental activity since the management company provided many services; (2) the taxpayers did not preform more services than the management company, and (3) the taxpayers did not participate in the rental activity on

a regular, continuous and substantial basis during the year. **Chapin v. Comm'r, T.C. Memo. 1996-56**.

PENSION PLANS. For plans beginning in February 1996, the weighted average is 7.01 percent with the permissible range of 6.31 to 7.57 percent (90 to 109 percent permissable range) and 6.31 to 7.71 percent (90 to 110 percent permissable range) for purposes of determining the full funding limitation under I.R.C. § 412(c)(7). **Notice 96-11**.

The decedent owned an interest in a qualified pension plan and an IRA. The surviving spouse was the beneficiary of both plans and elected to have the funds in the pension plan rolled over to the IRA and elected not to have the IRA transferred to the surviving spouse's name. The IRS ruled that the surviving spouse did not recognize income from the rollover of the pension plan funds to the IRA, distributions from the IRA to the surviving spouse prior to the date that the surviving spouse reached age 59 1/2 were not subject to the 10 percent early distributions tax, and the IRA would not be treated as the surviving spouse's IRA. **Ltr. Rul. 9608042, Dec. 1, 1995**.

SAFE HARBOR INTEREST RATES
March 1996

	Annual	Semi-annual	Quarterly	Monthly
		Short-term		
AFR 5.05	4.99	4.96	4.94	
110% AFR	5.57	5.49	5.45	5.43
120% AFR	6.08	5.99	5.95	5.92
		Mid-term		
AFR 5.45	5.38	5.34	5.32	
110% AFR	6.01	5.92	5.88	5.85
120% AFR	6.56	6.46	6.41	6.37
		Long-term		
AFR 6.07	5.98	5.94	5.91	
110% AFR	6.69	6.58	6.53	6.49
120% AFR	7.31	7.18	7.12	7.07

S CORPORATIONS-*ALM* § 7.02[3][c].*

INADVERTENT TERMINATION. An S corporation amended its articles of incorporation to provide for two classes of stock, preferred stock and common stock. The two classes had different voting and economic rights. The corporation did not realize that the creation of the two classes of stock would terminate the Subchapter S corporation election until informed by counsel. The corporation immediately amended the articles of incorporation to eliminate the second class of stock. The IRS ruled that the termination of the S corporation status would be waived as inadvertent. **Ltr. Rul. 9608012, Nov. 13, 1995**.

STOCK REDEMPTION. The taxpayers were beneficiaries of a QSST trust which held S corporation stock. The S corporation had accumulated earnings and profits from its years as a C corporation. The corporation redeemed stock in the trust for cash equal to the fair market value of the stock. The corporation did not plan to issue, redeem or exchange any additional stock and no other shareholder was required to purchase the redeemed stock. The IRS ruled that because the reduction in the trust's share of stock in the corporation was not a meaningful reduction, the redemption of the stock was essentially equivalent to a dividend. The IRS also ruled that (1) the distribution to the trust was not included in the trust's income to the extent the distributions did not exceed the accumulated adjustments account at the close of the tax year and did not exceed the trust's basis in the stock; (2) the basis of the redeemed shares was decreased by the amount of the distribution; (3) if the distribution exceeded the aggregate basis of the redeemed shares, the excess distribution decreased the basis of the remaining shares held by the trust; and (4) if the distribution was less than the aggregate basis of the redeemed shares, the remaining basis in the redeemed shares increased the basis of the remaining shares held by the trust. **Ltr. Rul. 9607003, Nov. 3, 1995**.

TRAVEL EXPENSES. The taxpayer operated a tree trimming business and claimed expenses, primarily fuel expenses, for operating a truck in the business. The taxpayer provided only charge slips for fuel purchased at a gasoline station. However, the taxpayer presented no evidence that the charges were paid during the taxable year or that the fuel was used in the business; therefore, the court held that the expenses could not be claimed in excess of the amount allowed by the IRS. **Fritz v. Comm'r, T.C. Memo. 1996-73**.

WITHHOLDING TAXES. The taxpayer owned 50 percent of two corporations and was employed by the corporations. The taxpayer retired from the employment positions with the corporations and entered into an agreement for the repurchase of the stock by the corporations. The corporations also agreed to provide the taxpayer with weekly payments for 10 years as consideration for the taxpayer's past services to the corporations. If the taxpayer died before the end of the 10 years, the remaining payments would be made to the taxpayer's spouse. The IRS ruled that the payments would be wages for purposes I.R.C. § 3401 and would be subject to employment taxes. The IRS also ruled that the taxpayer could not elect to have no withholding under I.R.C. § 3405 because the payments were wages under I.R.C. § 3401. **Ltr. Rul. 9607009, Nov. 9, 1995**.

PRODUCT LIABILITY

PESTICIDES. The plaintiff was injured after using a pesticide manufactured by the defendant. The pesticide was a dip used to remove fleas from the plaintiff's dogs. The plaintiff did not wear protective clothing and suffered injury from skin exposure to the pesticide. The plaintiff sued for negligence and breach of implied warranty of merchantability. The defendant argued that the actions were prevented by the preemption of FIFRA because the actions were based on a failure to warn. The court held that the actions were preempted by FIFRA. **Hochberg v. Zoecon Corp., 657 N.E.2d 1263 (Mass. 1995)**.

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TRESPASS

TIMBER. The plaintiff sued the defendant for the unauthorized cutting of timber on the plaintiff's property. The plaintiff sought and was awarded actual and punitive damages. The actual damages were trebled under W. Va. Code § 61-3-48a and the defendant argued that the punitive damage award was improper because the treble damages provision was already a punitive damage award. The court noted that the legislative purpose of the treble damage statute was to compensate more adequately the property owner for the loss of the trees because the normal measure of damages would not be sufficient after considering the litigation costs to the plaintiff. The court held that the plaintiff could receive punitive damages in an action for treble damages because the treble damages were only compensatory and not punitive. **Bullman v. D & R Lumber Co., 464 S.E.2d 771 (W. Va. 1995)**.

CITATION UPDATES

Carroll v. Comm'r, 71 F.3d 1228 (6th Cir. 1995), ***aff'g*****, T.C. Memo. 1994-229** (S corporation election) see p. 15 *supra*.

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